



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
VINNELL CORPORATION)

Appearances:

For Appellant: David M. Bridges
Attorney at Law

For Respondent: Paul J. Petrozzi
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Vinnell Corporation as transferee of Vinnell International Corporation against proposed assessments of additional tax and penalties for failure to file returns in the amounts and for the years as follows:

Appeal of Vinnell Corporation

<u>Income Year</u>	<u>Proposed Assessment</u>	<u>Penalty</u>
1960	\$15,644.59	\$3,911.15
1961	13,260.39	3,315.10
1962	5,400.23	1,350.06
1963	6,221.55	1,555.39
1964	17,824.13	4,456.03
1965	3,174.60	793.65
1966	6,184.31	1,546.08
1967	2,628.08	657.02

The central issue in this appeal is whether the commercial domicile of Vinnell International Corporation (VIC) was in California. If it was not, respondent's assessment of tax and penalties was improper. If, on the other hand, VIC's commercial domicile was in California, respondent's assessment was proper subject to the host of defenses raised by appellant which would serve to reduce or invalidate the assessment.

The parties have entered into a stipulation of facts. Additional testimony and documentary evidence was introduced by appellant at the hearing. The pertinent facts, as determined, are summarized below.

Appellant is a California corporation with its **principal office located in Alhambra, California.** Appellant is engaged in the heavy construction contracting business in the United States and abroad. In 1952 VIC was incorporated in Panama and was wholly owned by appellant until its liquidation into appellant in December 1968. VIC was also engaged in the heavy construction **contracting** business, although its business activities were limited to foreign countries. Although VIC maintained the required registered office in Panama, it conducted no business activities in Panama. Similarly, VIC had no tangible property, sales, or payroll in California, and the parties stipulated that VIC did no business in California. Appellant's franchise tax returns for the appeal years indicated that **VIC's principal place of business** was located in Iran. The record also indicates that VIC was required to and did pay Iranian taxes.

At different times during the years in issue it appears that VIC had a total of seven directors and sixteen officers. All of the directors resided in California as did eleven of the officers. However, documents introduced at the hearing indicated that it was three of the officers, including Mr. A. S. Vinnell,

Appeal of Vinnell Corporation

the president, who had plenary authority to conduct the affairs of the corporation. Two of these three officers resided overseas. Additionally, during the appeal years VIC's assistant secretary and general counsel was stationed overseas to provide legal assistance and negotiating support. Mr. Vinnell, who was president of both appellant and VIC, was a dominant figure in the overall direction of VIC's worldwide operations. Although Mr. Vinnell resided in California during the appeal years, he exercised his duties as president of VIC during his constant travels to VIC's regional offices.

VIC maintained several regional offices in Europe and the Far East, where the business of the corporation was conducted under the management of VIC's overseas executive officers. At regional headquarters in Rome, Tokyo, Sydney, Wiesbaden and Seoul, VIC had engineering and estimating staffs, clerical, accounting and sales personnel, and project management and supervisory offices. It was at these locations, outside California, where VIC's estimates and proposals were prepared, presentations were made to clients, billing, accounting and banking functions were performed and contracts were approved and entered into by VIC's officers. These activities were carried out independently at each regional office under the direct control of one of VIC's overseas executive officers. VIC's projects were actively managed and coordinated from these regional offices. No regional office directed activities in any other regional office's area. In addition to the regional offices, at various times during the appeal years, VIC maintained project offices in Pakistan, Afghanistan, Korea, New Zealand, Iran, Libya and Lebanon. All of VIC's construction projects were financed by advance payments from VIC's clients, which were paid into project bank accounts administered at VIC's foreign project offices. VIC's project offices paid all job costs, including subcontractors' costs, fees and claims, from these project bank accounts. At no time did VIC pay job costs from California. VIC's total business income from foreign construction projects and related operations during the appeal years exceeded \$2,000,000.

During the years in issue, VIC owned 1,375 shares of the capital stock of La Victoria y Asociados, S.A. (La Victoria), a construction company incorporated and operating solely in Mexico. VIC's 1,375 shares constituted 55 percent of La Victoria's outstanding voting stock, enabling VIC to control the operations and policies of La Victoria. It was necessary for VIC to acquire controlling interest in La Victoria since the Mexican

Appeal_of Vinnell Corporation

government prohibited foreign construction companies from bidding on public works contracts. VIC was also required to obtain a permit from the Mexican Ministry of Foreign Relations to own the controlling interest in La Victoria since Mexican law prohibited such ownership in the absence of a permit. Under the terms of the permit the stock could only be sold to Mexican nationals.

The certificates representing VIC's stock in La Victoria were bearer certificates. In order to vote the shares it was necessary, under the charter of incorporation, to physically present the shares, or a certificate evidencing their deposit with a bank, at the stockholders' meetings which were held in Mexico City. VIC did furnish such a certificate to its attorneys in Mexico City, evidencing that the shares were on deposit with the Bank of America in Los Angeles, so that the shares could be voted by proxy. The stock certificates bore dividend coupons which were required by La Victoria's charter to be surrendered in Mexico City in order to receive any dividends declared on the stock. During the years in issue, VIC received dividends from La Victoria in the total amount of \$1,023,064. These dividends were subject to the Mexican income tax. Additionally, La Victoria's income was subject to the Mexican gross receipts tax.

As mentioned above, during the appeal years, VIC conducted no business in California and had no tangible property, sales, or payroll here. VIC's board of directors met periodically in California for the purpose of reviewing and approving, after the fact, the management decisions made by VIC's overseas officers, sometimes in conjunction with Mr. Vinnell, the president, at their foreign offices. At all times prior to VIC's liquidation, the only book of account which was maintained within California was VIC's general ledger which was kept in Alhambra for the convenience of appellant, VIC'S sole shareholder. The contents of the general ledger were limited to VIC's capital structure, major assets, annual profit or loss, dividend and interest income, VIC'S dividend and other disbursements to appellant, and occasional joint venture contributions. All of VIC's project (job) ledgers were kept at the overseas offices, which handled all project financial transactions. The project ledgers were closed to profit and loss in the corporate general ledger only at the end of the year.

VIC maintained a sizable bank account with the Rank of America in Los Angeles. This account was used to receive VIC's ultimate profit from foreign construction work. Interest received from funds invested in

Appeal of Vinnell Corporation

certificates of deposit and dividends from La Victoria were also deposited into this account. VIC made disbursements from the Los Angeles bank account to pay dividends to appellant, to make capital contributions to occasional joint ventures, to reimburse appellant for advances on account of salary for American expatriates employed on VIC projects, and to pay registration fees for its offices in Panama and at other overseas locations. At no time did VIC borrow money in California to finance overseas construction work, nor did it ever pay job costs from its California bank account.

VIC's total income from business and related operations was \$2,051,925 during the appeal years. During the same period its income from intangible property, dividends from La Victoria and interest from certificates of deposit, was \$1,306,915. During this period VIC paid dividends to appellant in the total amount of \$987,019. In 1968 VIC paid additional dividends of \$740,000 to appellant who also realized an additional gain on the liquidation of VIC in the amount of \$1,725,490. Appellant paid the appropriate California taxes on all the dividends received from VIC and on the gain realized upon VIC's liquidation.

During the years in issue, no business income of VIC was apportioned to California and respondent does not assert that VIC was part of appellant's unitary business.

At no time prior to its liquidation into appellant in 1968 did VIC ever file a California franchise or corporate income tax return. During the course of an audit of appellant, ^{1/} respondent concluded that, although

^{1/} In September 1967 respondent began to audit appellant's franchise tax liability for the years 1952 through 1966. Appropriate waivers of the statute of limitations were obtained to prevent issuance of an arbitrary assessment. In December 1967 appellant's federal income tax liability for the years 1959 through 1963 was resolved by the United States Tax Court. Thereafter, appellant submitted a notice of federal adjustment to respondent which assessed the corresponding additional tax on February 28, 1969. On the same date, respondent concluded its own review of appellant and its subsidiaries for the years 1952 through 1966. Initially, the auditor had

(Continued on next page.)

Appeal of Vinnell Corporation

VIC did no business in California, it maintained sufficient contacts in California to constitute this state its commercial domicile. Consequently, respondent determined that VIC's income from intangible property was from a California source and, therefore, taxable by this state. Since VIC had never filed California tax returns, no statute of limitations barred assessment. (See Rev. & Tax. Code, § 25732.) Accordingly, respondent issued a notice of proposed assessment for each year involved seeking to tax VIC's intangible income as follows:

<u>Year</u>	<u>Dividends From La Victoria</u>	<u>Interest</u>
1960	\$279,200	\$10,234
1961	248,864	57
1962	88,000	15,187
1963	88,000	25,119
1964	264,000	60,075
1965	--	57,720
1966	55,000	57,442
1967	--	58,017

The liability was asserted against appellant in its capacity as the transferee of VIC. (See Rev. & Tax. Code, § 25701a.) Appellant's protest was denied and this appeal followed.

It is respondent's position that VIC maintained such contacts, and exercised such management and control

1/ (Continued)

recommended inclusion of \$520,000 of VIC's income from intangibles in appellant's income. However, for reasons that do not appear in the record, this proposal was dropped. Although the proposed assessment was protested, appellant apparently paid tax and interest in excess of \$130,000 in finally resolving the dispute. In its 1968 franchise tax return appellant reported \$740,000 in dividends received from VIC and a \$1,725,490 gain realized on the liquidation of VIC. The resulting tax was \$118,379. Had appellant claimed a deduction in regard to the amounts presently in issue pursuant to Rev. & Tax. Code, § 24402, such deduction would have reduced the tax shown on appellant's 1968 return by approximately \$88,344, which is about the same as the amount of tax presently in issue. The notices of proposed assessment presently in question, covering VIC's income years 1960 through 1967, were not issued until March 14, 1973.

Appeal of Vinnell Corporation

of its operations in California, that this state was the corporation's commercial domicile with jurisdiction to tax its income from intangible property.

For purposes of taxation, intangible property must be assigned a **situs**. Traditionally, based on the common law doctrine of mobilia sequuntur personam, the tax **situs** of intangibles was coincident with the owner's domicile. The legal domicile of a corporation and, therefore, the **situs** of its intangible property, is presumed to be in the state of incorporation. (Newark Fire Insurance Co. v. State Board of Tax Appeals, 307 U.S. 313 [83 L. Ed. 1312] (1939); Appeal of Rajaw Realty, Cal. St. Bd. of Equal., June 6, 1968.) In appropriate circumstances, however, this presumption may be overturned since domicile, if limited to the state of incorporation, can often be an unsatisfactory test of jurisdiction to tax. It would be unrealistic to allow the state of incorporation to tax all the income of a corporation, including its income from intangibles, where the corporation has no office and does no business in that state, while denying such jurisdiction to the state where the business of the corporation is conducted and controlled. Recognition of this problem has given rise to exceptions to the mobilia rule. One of these exceptions is that the foreign state where a corporation has **established** its "commercial domicile", at least in reference to the intangibles in question, has jurisdiction to tax those intangibles. (See, e.g., Wheeling Steel Corp. v. Fox, 298 U.S. 193 [80 L. Ed. 1143] (1936); Southern Pacific Co. v. McColgan, 68 Cal. App. 2d 48, 72 [156 P.2d 811] (1945); Appeal of Norton Simon, Inc., Cal. St. Bd. of Equal., March 28, 1972.)

The concept of commercial domicile has been described in various ways: the headquarters for the transaction of business or the principal office from which the corporate management is conducted (Southern Natural Gas Corp. v. Alabama, 301 U.S. 148, 153 [81 L. Ed. 970] (1937)); the place where the corporation is managed and operated (Smith v. Ajax Pipe Line Co., 87 F.2d 567 (8th Cir. 1937)); the state where, under the facts, the corporation receives its greatest protection and benefits, that state where the greatest proportion of its control exists (Southern Pacific Co. v. McColgan, supra, 68 Cal. App. 2d at 81); the state where the corporation maintains its general business office, the center of authority, the actual seat of the corporate government (Wheeling Steel Corp. v. Fox, supra, 298 U.S. at 211-212); the place from which **the corporation's** business is managed (Memphis Natural Gas Co. v. Beeler, 315

Appeal of Vinnell Corporation

U.S. 649, 652 186 L. Ed. 10901 (1942)); the state in which the corporation engages in its greatest and most centralized activity (Appeal of Flexible, Inc., Cal. St. Bd. of Equal., Nov. 23, 1966), ~~and the place from which~~ the business is directed and controlled and where a major part of the business is conducted (Appeal of Safeway Stores, Cal. St. Bd. of Equal., March 2, 1962). Although ~~the location~~ of actual management and control has repeatedly been stressed as a major factor in determining the situs of a corporation's commercial domicile, the location of ultimate control has been rejected where it does not coincide with the place of actual management and control. (See Smith v. Ajax Pipe Line Co., supra; Southern Pacific Co. v. McColgan, supra, 68 Cal. App. 2d at 79-80.) ^{2/}

In regard to the location of a corporation's commercial domicile the court in the leading California case, Southern Pacific Co. v. McColgan, supra, has stated:

We perceive the law to be that where the corporation has only a paper domicile, where the only function performed by the state of incorporation is to breathe life into the corporation, and where no substantial corporate

2/ There is language in two prior opinions of this board that might be construed as suggesting a corporation's commercial domicile is located at the place where the ultimate power to control the corporation's business affairs is located. (See Appeal of Norton Simon, Inc., supra; Appeal of Flexible, Inc., supra.) Upon analysis, however, these decisions are not inconsistent with the proposition that it is the location where actual control is exercised which is important in pinpointing a corporation's commercial domicile, since, in both cases, the location where actual control and ultimate control were exercised coincided. In Norton Simon the actual control of the corporation's business activities was exercised by a duly authorized executive committee located in California. In Flexible, although the sales activities of the corporation were controlled by a sales manager at the corporation's legal domicile in Texas, there is no indication that the actual overall direction of the corporation was exercised other than in California. In this regard, it should be noted that the taxpayer was engaged not only in selling but also in manufacturing the products sold.

Appeal of Vinnell Corporation

activities are thereafter carried on in that state, then the law looks at such corporation and says that that state where, under the facts, the corporation receives its greatest protection and benefits, that state where the greatest proportion of its control exists, that state shall be the commercial domicile, with constitutional power to tax income from intangibles. (68 Cal. App. 2d at 81.) (Emphasis added.)

On the basis of the record before us, we cannot conclude that the greatest proportion of VIC's control was exercised here, or that VIC received sufficient benefits and protection from California to constitute this state VIC's commercial domicile.

The stipulated facts reveal that VIC was a Panamanian corporation engaged in the construction contracting business carried on entirely outside the United States and actively managed from foreign operating offices in Europe and the Far East by resident corporate officers.

In seeking to establish a corporate commercial domicile in California, respondent contends that "overall cognizance of VIC's affairs" was maintained in California. If, by this assertion, **respondent** is arguing that the ultimate power to control VIC, either through its board of directors or through appellant, its sole shareholder, was located in California, such argument must be rejected. As noted above, the suggestion that a corporation's commercial domicile is necessarily coincident with the location of ultimate control has been rejected. (Smith v. Ajax Pipe Line Co., supra; see also Southern Pacific Co. v. McColgan, supra, 68 Cal. App. 2d at 79-80.)

If, on the other hand, respondent is asserting that California was the place from which VIC's affairs were actually managed and controlled, its position is not supported by the record. The record indicates that all of VIC's business activities were managed and controlled regionally with no center of active operational control. This management and control was exercised by Mr. Vinnell, VIC's key executive and president, in conjunction with its resident foreign officers who had plenary authority to shape the corporation's overall policies as well as to conduct its daily affairs. Mr. Vinnell's central direction of all overseas operations was exercised during his frequent personal visits to the various overseas offices where the actual decision-making process occurred with respect to broad-ranged policy matters as well as current operational questions. (See Appeal of Rajaw Realty, supra.)

Appeal of Vinnell Corporation

Notwithstanding the fact that VIC was engaged throughout the world in a variety of construction projects worth millions of dollars, it is noteworthy that respondent has failed to point to a single management decision that originated in California. It is true that, when required, the board of directors ultimately ratified the broad-ranged management decisions made in the field. But this passive acquiescence, after the fact, is not the active management and control required to establish a commercial domicile and the ultimate power to tax a foreign corporation's intangible income. (See Southern Pacific Co. v. McColgan, supra.)

In furtherance of its attempt to establish California as VIC's commercial domicile, respondent points to certain contacts between the corporation and this state. The existence of these contacts, respondent alleges, establishes that California provided VIC with sufficient benefits and protection to empower the state to tax the corporation's income from intangible property. The contacts relied upon by respondent include: board of directors' meetings in California; maintenance of VIC's general ledger in California; and maintenance in California of a bank account and a safe deposit box in which the La Victoria share certificates were kept.

Initially, we note that the court in Southern Pacific Co. v. McColgan, supra, 68 Cal. App. 2d at 80 ~~rejected~~ the argument that, as a matter of law, the state where the board of directors meet is the foreign corporation's commercial domicile. It was to free the law from such artificiality that the intensely practical concept of commercial domicile was developed. We view the other contacts relied upon by respondent as equally artificial and lacking in substance, especially when considered in the context of a foreign corporation that did no business in California. (See Southern Pacific Co. v. McColgan, supra, 68 Cal. App. 2d 64-66.) We also note that the contacts relied upon by respondent are substantially the same as those advanced by the taxpayer to establish a New York commercial domicile which were rejected by the court in Southern Pacific.

VIC's general books of account were not kept in California. It was only VIC's general ledger which reflected the corporation's capital structure, major assets, and annual profit or loss that was located in this state for the convenience of appellant, VIC's sole shareholder. The actual operating records and books of account were kept at the foreign project offices where

Appeal of Vinnell Corporation

the recordation of revenues and expenses relating to **VIC's** construction activity was performed by project accountants under the supervision and control of **VIC's** resident foreign officers.

The bank account in California was not an active business bank account in the sense of an operating account. All operating income and expenses relating to specific construction projects were deposited to or withdrawn from specific project bank accounts maintained at the appropriate foreign location. For all practical purposes, the only deposits to this account were **VIC's** dividend and interest income and residual funds, while the only withdrawals of consequence were foreign registration fees, certain transfer charges, and dividends payable to appellant.

Finally, the fact that the La Victoria share certificates were physically located in California does not aid respondent materially. Mere presence of the physical evidence of the intangibles in a state does not compel the conclusion that that state is the commercial domicile. (See Southern Pacific Co. v. McColgan, supra, 68 Cal. App. 2d at 70-72; Smith v. Ajax Pipe Line Co., supra.)

On the basis of these tenuous contacts, either singularly or in combination, we cannot conclude that California accorded sufficient benefits and protection to **VIC**, a foreign corporation that did no business in this state, so that the state may tax the corporation's income from intangible property on the theory that California was the corporation's commercial domicile.

In accordance with the views expressed above, respondent's action in this matter must be reversed.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Vinnell Corporation

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Vinnell Corporation as transferee of Vinnell International Corporation against proposed assessments of additional tax and penalties for failure to file returns in the amounts and for the years as follows:

<u>Income Year</u>	<u>Proposed Assessment</u>	<u>Penalty</u>
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1965	3,174.60	793.65
1966	6,184.31	1,546.08
1967	2,628.08	657.02

be and the same is hereby reversed.

Done at Sacramento, California, this 4th day
of May , 1978, by the State Board of Equalization.

Geoff Healy, Chairman
Paul K. Lee, Member
W. S. Sankar, Member
Shallanla Bernick, Member
_____, Member